



## Weekly Bulletin – 5<sup>th</sup> February 2007

The UK market starts this week in a fairly nervous state as worries have emerged that the MPC will raise rates again after their meeting on Thursday. While most surveys of economists show a very small minority actually expecting the MPC to raise rates again, it is perhaps not surprising, after last month's 'shock', that equally few are willing to count out the possibility of further action as being out of the question.

Almost all of the news that has emerged since the last MPC meeting has supported their fears that inflationary pressures are being passed through to consumers with relatively little problem and that, in turn, this will fuel overly generous wage settlements. Last week's BA cabin staff deal providing an increase of 4.6% will not have done much to calm their nerves. The IDS wage settlements survey for January showed average increases rising from 3.05% in December to 3.5% in January. The rate of increase will be a further concern to the MPC even if the actual level is still relatively moderate.

One item of news arguing against a rate hike that did emerge last week was the reduction in mortgage applications. These showed a fall from 129,000 in November down to 113,000 in December, the second largest monthly fall since these statistics started to be published twenty years ago. While one month's figures should not be taken in isolation, if this was a reaction to November's rate hike, the potential for further reductions following the latest rate increase, and the implications for house prices, should be considerable.

However, the MPC's concerns are likely to remain with the inflation level and wage increases. It is unlikely that they will start to relax about the latter until the wage settlement season is over. That will mean waiting until May's figures have been released without a major hiccup before the market can start to relax.

By the time the MPC meet on Thursday they will have already had sight of this month's inflation figures. It had been hoped that the CPI measure would have shown a reasonable fall from the current 3.0% level on the back of markedly lower oil prices. However, according to figures released by the AA, petrol prices fell back by less than 1% in January. While this should be sufficient to take 0.1% off the inflation rate, it would not take much of an increase in other constituents of the index to offset this reduction and more. The scope for the Governor having to write to the Chancellor remains strong and a rise in the CPI

measure to above 3.0% would be the most likely catalyst for a rate hike on Thursday.

The ECB also meets on Thursday with the market fairly convinced that they will leave rates on hold, although a rate increase is still confidently expected in either March or April. The reason for the market's confidence is the relatively relaxed announcement after last month's meeting. The market assumes that, as it has not been prepared for a rate increase, it is unlikely to be surprised. Having just been shocked by the MPC, UK observers may take this sanguine attitude rather less confidently. Furthermore, the economic news that has emerged from the major eurozone countries has hardly been equivocal. Last week both Germany and France announced much greater reductions in unemployment than had been expected. In the case of the former, December showed a whopping fall in unemployment of 106,000 which brought the unemployment rate down from 9.8% to 9.5%. Germany even showed a strong set of retail sales figures and France benefited from improved consumer confidence. With inflation having crept back up to the ECB's target level, there should be no real reason why the market should be surprised if the ECB decided to act this week.

There are a number of interesting domestic economic releases this week. First up (today) will be the latest CIPS survey on the service sector. Having reached a heady 60.6 level last month, and being a constituent part for the MPC's interest rate decision, the index is expected to fall back this month to about 60. The BRC sales monitor is released tomorrow and is expected an increase in the annual like for like growth sales value. However, this is largely down to last year's very poor figure for January trading dropping out of the index rather than any stellar performance this year. Wednesday's industrial production figures are expected to remain weak while Thursday's trade figures will reflect the normal major deficit.

The UK is likely to remain in a nervous state until Thursday's meeting has passed without any alarms. Thereafter, there should be scope for a minor rally. Both the US and EUR markets have started this week in a more relaxed fashion with term rates having staged a reasonable rally. Not so the UK market, but it may feel more inclined to be influenced by global markets, assuming they maintain current levels, once, and if, the MPC holds off from tightening monetary policy by another notch.

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